ROMANIA'S FISCAL REFORM PACKAGE & ITS IMPLICATIONS FOR INVESTORS

Analysis & Implications of the Recently Introduced Package of Corrective Fiscal Measures

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EXECUTIVE SUMMARY

Following weeks of public consultation and pushback from the local business communities, Romania's grand coalition government has adopted a major fiscal policy reform package aimed at improving the country's public finances and curbing the budget deficit. The package is crucial to Romania continuing to receive post-pandemic EU recovery funds, needed for ensuring infrastructure development and economic growth.

Introduced by Romanian Prime Minister Marcel Ciolacu, the package holds wide-reaching implications for international businesses, large companies, SMEs, households and the public sector. Most importantly, from a corporate perspective, the government is set to impose a conditional turnover tax on companies with over €50 million in annual turnover, a separate turnover tax on banks, while businesses in a number of other sectors could also see tax increases.

The corrective fiscal measures have been criticized by some investors, business associations and academics, while a part of the opposition also challenged the measures at Romania's Constitutional Court, which is set to make a final decision on the application of the package on 18th October. At the same time, Aretera's baseline scenario assumes that the stability of Romania's governing coalition will remain unaffected and the fiscal package will likely be enforced as planned by the government.

This memo will cover:

- an overview of the government's fiscal consolidation effort,
- key measures included in the fiscal policy package,
- short-term political and policy implications,
- the possible impact on foreign investors in Romania.

A MUCH-ANTICIPATED ANNOUNCEMENT

On 25th September, Romania's grand coalition government unveiled the final version of a much-anticipated package of corrective fiscal policy measures to ensure Romania's long-term financial stability, whilst preventing the loss of European funds. Most of the new measures will apply from January 2024.

According to Romanian Prime Minister Marcel Ciolacu, the reform package is designed to achive social fairness through balancing labour and capital taxation, fighting the tax evasion of an estimated RON 150 billion (€30.15 billion) per year, as well as eliminating allowances "the Romanian economy can no longer afford." The government assumed responsibility for the package during a joint session of the Romanian parliament on 26th September, when its final version was presented to the lawmakers of the Chamber of Deputies (lower house) and the Senate (upper house).

A FAR-REACHING SET OF NEW MEASURES

The fiscal policy package presented by PM Ciolacu has a number of implications for international businesses and large corporations operating in Romania, as well as for SMEs, IT workers and the public sector. Among a range of measures, the package includes:

- **a 1% turnover tax on large companies**[1] with €50 million plus of annual turnover (to be paid only if their profit tax is lower than the floor set by the new turnover tax);
- **a 2% turnover tax on banking institutions** for the next two years, reduced to 1% from 2026;
- **a new taxation system for SMEs** with a 1% tax for small business with annual revenues below €60,000 and 3% for businesses with revenues above €60,000;
- **conditional VAT increases** for a number of services, including social housing, food delivery, drinks delivery (in certain cases), fitness clubs, amusement and recreational parks, sports events, tickets, malls, as well as the installation of solar thermal/photovoltaic panels, heat pumps and other high-efficiency heating systems;
- **a new tax on the income of IT workers** for amounts exceeding RON 10,000, following years of tax exemption for workers in the IT industry;
- **special taxes for owners** of high-value homes (above €500,000) and high-value vehicles (above €75,000);
- **public sector cuts,** including limits on the number of public sector workers eligible for food vouchers and hazard allowances;
- **measures to reduce the budget apparatus** aimed at cutting the number of the positions of secretary of state, state adviser, undersecretary of state, vice president by 25%;
- **new social security contribution requirements** for employees working in food production, agriculture and construction;
- **new excise duties** on certain tobacco products (e-cigarettes) and soft drinks with added sugar above certain values;
- **additional measures** to counter tax evasion and ensure fiscal discipline, as well as provisions for electronic invoicing.

[1] Exempt from the new turnover tax are distribution, supply and transport companies in the electricity sector and the natural gas industry. The turnover tax is expected to raise an annual RON 6.2 billion (€1.25 billion) from 750+ companies. The package also includes food vouchers for low-income workers and raising the minimum wage to RON 3,300 as of October 1, 2023.

FISCAL CONSOLIDATION AMID BROAD CONCERNS

The Romanian government's fiscal reform package follows weeks of heated public consultation and after the country started facing increasing pressure from the European Commission to balance the budget in order to preserve the country's eligibility for EU cohesion and post-pandemic recovery funds.

Critics argue that the country's coalition government – supported by the centre-left Social Democratic Party (PSD) and the centre-right National Liberal Party (PNL) – overestimated its budget revenues for 2023, with the cabinet now expecting a 5.5% budget deficit for this year instead of a previously budgeted 4.4%. Through the implementation of the announced corrective measures, the government hopes to improve fiscal stability and subsequently prevent the loss of any EU funds, which have been crucial to infrastructure development and economic growth. Simultaneously with the adoption of the package, the EBRD has lowered its 2023 GDP growth forecast for Romania from 2.5% to 1.8%, while the country's fiscal deficit is expected to reach 7% of GDP this year.

While the PSD-PNL coalition government remains committed to ensuring fiscal stability and the flow of European Union funds through the reform package, the measures have been criticized by some companies, investors, associations and academics. The government decided to adopt the package despite the negative review of the country's Economic and Social Council (CES), which remains primarily concerned about the increased tax burden on large companies and SMEs. The CES believes the package will fail to significantly reduce public expenditure. The country's Foreign Investors' Council is also worried that the new fiscal policy measures put future investments "under a question mark."

POLITICAL IMPLICATIONS

Given the urgency for reform, the government chose a fast-track procedure to adopt the package. PM Ciolacu presented the draft law to parliament on 26th September; parties and lawmakers opposed to the measures then had just three days to file a motion of no confidence motion against the government. Since this did not happen, the law on the fiscal measures was passed.

Responding to the final version of the package and denouncing it as austerity, two of Romania's opposition parties (the centrist-liberal Save Romania Union (USR) and the conservative Force of the Right party of ex-Prime Minister Ludovic Orban) have moved to challenge the package at the Constitutional Court of Romania (CCR). Most of the new measures are expected to apply from 2024, however the CCR will make the final decision on the package's applicability, expected to be announced on 18th October.

The much-debated fiscal package comes as Romania is scheduled to hold presidential, parliamentary, local and EU elections in 2024. While the recently restructured coalition government[2] of the PSD and the PNL is likely to face a strong political challenge, leading opposition parties did not have enough votes to file a no confidence motion.

The fellow opposition Hungarian minority UDMR, previously a part of the governing coalition, also decided not to support the no confidence motion after the government agreed to incorporate the UDMR's policy suggestions into the fiscal package.

[2] See here for Aretera's overview of Romania's recent government restructuring from June 2023

Internal debates within the coalition may emerge over the effectiveness of certain measures as some in the government believe further measures may also be necessary to ensure fiscal stability in the long run. However Aretera's baseline scenario assumes that the stability of the PSD-PNL coalition will remain unaffected.

WHAT'S NEXT FOR BUSINESSES?

Romania's new fiscal policy package follows a growing trend among CEE governments, which have been pushed to introduce different types of special tax regimes, including windfall taxes, in the wake of the economic fallout from Russia's war against Ukraine and the Russia-fuelled energy crisis. Both supporters and opponents of the government's package have declared that furtherl measures may also become necessary to ensure the country's fiscal stability and the inflow of EU funds.

International businesses with a stake in Romania are advised to continuously monitor the developments around the adoption of the package, Romania's public finances and any future measures the government may implement. This is also suggested by a recent statement from Romanian Finance Minister Marcel Boloş, who said the government, which hopes to raise RON 1 billion (€200 million) from special taxes on banks, and oil/natural gas companies, may also consider changing the mining royalty levels paid by raw material companies.

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If you would like to schedule a discussion of this paper, please contact:
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